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Before the
FEDERAL COMMUNICATIONS COMMISSION
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FEDERAL COMMUNICATIONS COMMISSION
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In the Matter of:

Rulemaking to Amend Parts 1, 2, 21, 25
of the Commission's Rules to Redesignate
The 27.5-29.5 GHz Frequency Bands, To
Reallocate the 29.5-30.0 GHz Frequency
Band, To Establish Rules and Policies for
Local Multipoint Distribution Service
And for Fixed Satellite Services

Petition for Extension of the
Commission's LMDS Auction Date

CC Docket No. 92-297

PETITION FOR AUCTION EXTENSION

WebCel Communications, Inc. ("WebCel"), LBC Communications ("LBC"), and US WaveLink Telecommunications, L.P. ("US WaveLink") (collectively "Petitioners"), pursuant to Sections 1.106 and 1.429 of the Commission's Rules, 47 C.F.R. §§ 1.106, 1.429, hereby petition for an additional extension of at least 60-90 days in the commencement of the auction for Local Multipoint Distribution Service ("LMDS"), currently scheduled for February 18, 1998.

INTRODUCTION

Another valuable block of spectrum is at risk of being assigned for a fraction of its real value, largely due to a protracted failure to resolve key issues bearing directly on investor decision making. The Commission has recently released the data on the upfront payments collected for the fast-approaching LMDS auction. Even a cursory review of this data indicates that, as currently slated, the LMDS auction is likely to: (1) raise far less revenue than the \$2.4

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billion minimum target expected by the FCC; (2) result in a virtual give-away of licenses in major cities for the largest single block of spectrum ever auctioned by the Commission; and (3) shift the balance in favor of those bidders with easy access to capital and an interest in speculative arbitrage over those committed to developing new services.

The pronounced absence of firms who have pioneered the use of spectrum and helped craft the LMDS rules among the existing qualified bidders has been caused principally by the unsettled status of the regulatory environment. Throughout the pre-auction phase -- despite the Commission's best intentions and a 60-day delay in the auction date -- the policies and regulations bearing directly on the financial requirements for the LMDS auction have remained in a constant state of flux. Only in the past week have important questions been resolved, such as the final policy on foreign investment status, "attribution" rules for incumbent local exchange carriers ("LECs") and cable operators, and incumbent LEC and cable system eligibility for in-region licenses. At the same time, the Commission only recently eliminated installment payments for designated entities ("DEs"), fundamentally altering the financing requirements for their participation in the auction. In addition, the circumstances surrounding the recent C-Block auction has created much uncertainty among the investment community as to the value of spectrum. This extended uncertainty prevented DEs and others from closing strategic capital investments, resulting in very low upfront payments and thereby promising an extremely thin LMDS auction.

In order for the Commission to discharge its statutory auction obligations as the public caretaker of the valuable 1300 MHz of LMDS radio spectrum, and simultaneously to meet its own and Congress' objectives for auctions as a means of promoting telecommunications

competition, the Commission should delay the LMDS auction by at least 60-90 days. Doing so would provide the capital markets and prospective LMDS investors fair opportunity to sort out the significant decisions and changes that have occurred in the last 120 days. Such an extension would likely produce significantly higher upfront payments (and thus more compensatory auction revenues), and allow several *bona fide* DEs -- now effectively shut out of the auction due to regulatory uncertainty, an opportunity to raise the capital necessary not just to bid for licenses -- but to actually build-out competitive networks and provide new services. In addition, should the Commission choose not to delay the LMDS auction date, it must at least maintain the Commission's established minimum bid¹ as the "reserve price" for each license, holding the licenses for re-auction if the reserve price is not achieved in the auction. This will provide the public with a degree of protection against LMDS licenses being distributed to private hands below a minimum fraction of their quantifiable, intrinsic value.

DISCUSSION

I. GIVEN THE LOW LEVEL OF UPFRONT PAYMENTS, COMPETITION IN THE LMDS AUCTION WILL BE MARGINAL AT BEST AND LMDS SPECTRUM WILL BE DISTRIBUTED SIGNIFICANTLY BELOW ITS INTRINSIC VALUE

At the close of business on February 2, 1998, the Commission had collected only \$358 million in upfront payments from 139 potential LMDS bidders. These upfront payments were highly concentrated among only a handful of entities. Only the top five qualified bidders (representing 62% of the total upfront payments collected) submitted payments sufficient to

¹ Order, *In the Matter of Local Multipoint Distribution Service (LMDS), Minimum Opening Bids For Reserve Prices*, DA-98-66 (rel. January 14, 1998) ("*LMDS Minimum Bid Order*") at Appendix B.

conduct even a semblance of simultaneous multi-market bidding for the major markets, and only one, the venture capital consortium called WNP Communications, deposited more than \$50 million.²

It is public knowledge that the Commission staff has expected to raise no less than \$2.4 billion, and perhaps as much \$4.1 billion, from the LMDS auction. *Telecommunications Reports*, vol. 64, no. 6, at p.8 (February, 9 1998) (“LMDS spectrum assignments can be used for one- or two-way voice, video, or Internet links. Partly because the auction will market more bandwidth than has ever been sold at auction by the FCC, *the agency expects revenues of as much as \$4.1 billion from the sale.*”) (emphasis supplied). These numbers are consistent with Petitioners’ internal financial and market analysis. In addition, independent experts have estimated that the LMDS bandwidth has an intrinsic value at the upper end of FCC’s estimates. *See e.g., Wireless Services*, 1997 Annual Report, at p. 61 (November 25, 1997) (“The Strategis Group (Washington, D.C.) estimates the [LMDS] auctions *should generate over \$4 billion* with the licenses to serve top markets going for as much as \$30 per pop.”) (emphasis supplied).

The Commission’s past auction experience, however, indicates that not nearly enough capital has been deposited upfront to allow the FCC to reach anywhere near its \$2.4 billion minimum. In fact, Professor Harstad of Rutgers University, a contributor to the FCC’s original technical rules on spectrum auctions, has recently examined the current status of the LMDS auction and found that “only two bidders can compete simultaneously in the four largest markets,

² Except for Craig McCaw’s NEXTBAND Communications (\$50 million), the only parties making sizable upfront payments are two venture capital backed firms, which have filed for DE status. A total of 130 bidders deposited only \$102 million, or less than \$800 thousand per bidder. Among the DEs that were unable to raise sufficient capital to make upfront payments were WebCel, LBC, Zip, CellularVision, Jato and US WaveLink.

and less than a dozen can bid for any one of these four A block licenses.” *Competition in the LMDS Auction*, Dr. Ronald M. Harstad (Feb. 11, 1998) (Attachment 1). As a result, Dr. Harstad predicts that LMDS auction revenue “will not come close to the \$4.1 billion expectation.”

In establishing the auction process, Congress anticipated that spectrum licenses had significant value -- value that the public should share. Since that time it has criticized auctions such as WCS that resulted in effective give-aways. Congress stated that one of the objectives of its auction statute is “the recovery for the public of a portion of the value of the public spectrum resource . . . and avoidance of unjust enrichment through the methods employed to award uses of that resource.” 47 U.S.C. § 309(j)(3)(C). Holding the LMDS auction now, with the existing upfront investment levels, is bound to produce results that violate both of these objectives. First, the low upfront payments and their concentration in relatively few bidders will result in those bidders with the easiest access to capital being allowed to speculate in a sparse auction -- producing tremendous profits for themselves, while producing little or nothing in terms of new services or competition for the public. Second, as the expert testimony of Prof. Harstad makes clear, the public is going to receive revenues far below the forecasted 10-year intrinsic value of the spectrum. Petitioners’ Attachment 1.

In order to avoid this very result, Congress, in its recent amendments to the FCC’s auction authority, directed the Commission to “assure that, in the scheduling, of any competitive bidding under this subsection, an adequate period is allowed . . . after issuance of bidding rules.” 47 U.S.C. § 309(j)(3)(E). The purpose in adopting this provision is to “protect against future auctions that attract only a few participants because of insufficient time to gather the information necessary for a robust auction.” H.R. Rep. No. 105-149, 105th Cong., 2d Sess. at 567 (1997).

Moreover, Congress also expressed as a goal of the auctions “the development and rapid deployment of new technologies, products and services for the benefit of the public.” *Id.*

Petitioners believe these goals will not be met without the participation of experienced and committed telecommunications companies. A short delay in the auction will ensure that such companies are allowed every opportunity to participate.

II. LIMITED LMDS AUCTION PARTICIPATION IS THE DIRECT RESULT OF REGULATORY UNCERTAINTY AND INSUFFICIENT TIME

The 120 days leading up to the LMDS auction date of February 18 have been filled with regulatory uncertainty and rule changes that have delayed careful and deliberate investment decisions. On September 12, 1997, just six weeks prior to the original due date for upfront payments, the Commission issued its *Second Order on Reconsideration*³ eliminating installment payments from the LMDS auction. As a result, with almost no notice, the expected capital raise needed by a DE bidder jumped by nearly four-fold. The Commission subsequently recognized that after three years of rulemakings containing installment payments, this last-minute policy change failed to leave DEs sufficient time to raise capital for the auction, and thus on November 10 postponed the auction for 60 days to its current date. *Public Notice*, DA 97-2352 (Nov. 10, 1997).

A stated goal of the postponement was to “further opportunities for businesses to access additional sources of capital to further the advent of new competition in the cable television and

³ *Rulemaking to Amend Parts 1, 2, 21, 25 of the Commission's Rules to Redesignate The 27.5-29.5 GHz Frequency Bands, To Reallocate the 29.5-30.0 GHz Frequency Band, To Establish Rules and Policies for Local Multipoint Distribution Service And for Fixed Satellite Services*, Second Order on Reconsideration, CC Docket No. 92-297 (rel. Sept. 12, 1997), 62 Fed. Reg. 48786 (Sept. 17, 1997) (“*Second Order on Reconsideration*”).

local telephony marketplaces,” and to allow applicants to “take advantage of the World Trade Organization agreement to pursue additional sources of financing and investment.” *Id.*

Additionally, the Commission expected to use the delay to conclude consideration of outstanding petitions for reconsideration regarding the auctions rules.

The FCC’s well-intentioned 60-day extension, however, proved too short to achieve these objectives. First, despite the Commission’s expectation, the WTO Agreement on Basic Telecommunications Services was not concluded until January 26, 1998, just one week prior to the new upfront payments due date. For many potential bidders, especially DEs, the lateness of this decision raised significant barriers to the process of closing foreign investment deals in time for the February 2 deadline. Foreign investors, many of them world-class telecommunication companies already wary of US wireless regulatory proceedings, could not change gears fast enough to participate.

Moreover, several important issues bearing on financial participation in the LMDS auction were not resolved until *after* the deadline for upfront payments. In particular, four days after upfront payments were due, the U.S. Court of Appeals for the District of Columbia Circuit affirmed the Commission’s rules with respect to the eligibility of LECs and rural carriers to hold in-region licenses. Many major investors would not even consider becoming involved in LMDS until after these issues were clarified. Late resolution of this issue directly impacted the capital investment decisions of both LECs and rural carriers, and again served to hinder closure of significant investment resources. Equally important, on February 3 -- yet again, not until after

the upfront payments deadline -- the Commission adopted its *Third Reconsideration Order*,⁴ addressing a number of outstanding petitions for reconsideration. In addition, the text of the order itself was only released yesterday, February 11, more than one week after upfront payments were due. The *Third Reconsideration Order* denied requests that LECs be completely barred from participation in the auctions and affirmed that LECs can have up to 20% ownership interest in a licensee without violating the “attributable interest” rules. These determinations, exacerbated by Commission promises to conclude the proceeding months previously, further contributed to the poor turnout on February 2 because, like the Court of Appeals’ decision, the *Third Reconsideration Order* established the final rules under which LMDS investments must be structured. From a business perspective, standard principles of corporate due diligence dictate that it is only *after* these rules were finalized that a fair appraisal of the value of LMDS spectrum, and bidding strategy, could be made by the capital markets and strategic investors.

Finally, despite widespread attention in the press and calls for action by members of the House and Senate, the Commission has yet to address the closely related issue of the initial validity of nationwide licenses issued, without auction, in the 24 GHz block. The giveaway of these directly competing DEMS licenses by the Commission in March 1997, and the subsequent four fold increase in spectrum allocated to DEMS, has resulted in the short-term devaluation of spectrum assets and broad skepticism in the investment community regarding the FCC’s auction

⁴ *Rulemaking to Amend Parts 1, 2, 21, 25 of the Commission’s Rules to Redesignate The 27.5-29.5 GHz Frequency Bands, To Reallocate the 29.5-30.0 GHz Frequency Band, To Establish Rules and Policies for Local Multipoint Distribution Service And for Fixed Satellite Services*, Third Reconsideration Order, CC Docket No. 92-297 (rel. Feb. 12, 1998)(“*Third Reconsideration Order*”).

policies and process.⁵ Simply put, the capital markets are questioning whether any significant investment in spectrum auctions is economically rational while the Commission persists in awarding a national footprint of licenses, and expanding the scope of existing licenses, for free.

Until the DEMS issue is reconsidered, the LMDS and other spectrum auctions will necessarily be undervalued. To make matters worse, the beneficiaries of the DEMS relocation process have leveraged the market value of their freely acquired spectrum -- and revenues raised via initial public offerings -- to make upfront payments for the LMDS auction. Thus the FCC's delay in resolving the serious issues raised about the DEMS proceedings has not only resulted in a reduction in the capital raise for LMDS, it has provided the DEMS beneficiaries an opportunity to use their questionably expanded assets to buy into the LMDS market.

III. THE ONLY SOLUTION TO THE LOW TURN-OUT AND THE LACK OF BIDDERS CAPABLE OF PROVIDING REAL COMPETITION IS TO DELAY THE LMDS AUCTION AND ANNOUNCE RECONSIDERATION OF THE DEMS ISSUES

Rather than failing to meet the statutory objectives for the LMDS auction, the Commission should briefly delay the auction and allow for the market to "catch-up" to the final LMDS rules. An extension would cause no harm to currently qualified bidders, and in any event the individual interests of existing bidders pales in comparison to the potential one-time loss of spectrum that will result from a poorly attended auction. By providing the capital markets and serious telecommunications investors the opportunity to evaluate carefully the final regulatory environment of LMDS, the Commission can assure itself of increased financial participation and a more diverse field of potential bidders.

⁵ See, *WebCel Petition for Reconsideration*, E.T. Docket 97-99 (June 3, 1997).

IV. IF THE AUCTION PROCEEDS, THE COMMISSION SHOULD AT THE VERY LEAST MAINTAIN ITS MINIMUM BIDS AS THE RESERVE PRICE FOR THE LMDS LICENSES

Should the Commission decide to continue to auction on February 18, it must at the very least maintain its minimum bid schedule as the “reserve price” for both the A and B LMDS licenses. This would provide a partial protection against LMDS licenses being auctioned substantially below their quantified intrinsic value. Maintaining the minimum bid as the reserve price would guarantee that the Commission receives bids representing at least a small fraction of the intrinsic value for each BTA. For all licenses this would represent only \$458 million, or only 19% of the FCC’s \$2.4 billion expected LMDS income.⁶ Any revenue total below this level would represent a clear failure by the Commission of its statutory obligations to collect payment for distribution of valuable public property.


Petitioners support the FCC staff’s tentative position that a reserve price of at least 20% of the estimated intrinsic value supplies an appropriate safety net for the public, to the otherwise unpredictable auction process. Maintaining the minimum bid schedule as the reserve price is consistent with Congress’ loudly expressed concerns about the absurdly low bidding of the WCS auction. If the LMDS minimum bids are not achieved, the FCC should hold those licenses for a sufficient time for evaluation by the FCC and financial markets, and offer those licenses up for re-bidding at a later date in 1998.

⁶ *LMDS Minimum Bid Order* at Appendix B. Note, these calculations assume no bidding credits and thus total revenues must be reduced accordingly.

CONCLUSION

The Commission has an opportunity to prevent unintended regulatory uncertainty from making the LMDS auction a failure. There is no question that spectrum resources in general, and LMDS in particular, are suffering the "after shocks" of unsettled, uncertain and often-changing FCC regulatory policies. It would be tragic if the largest single block of spectrum ever auctioned by the Commission were to be bought up "on the cheap" largely because serious telecommunication investors, both US and foreign, did not have sufficient time to assimilate the final LMDS rules -- including the substantial decisions of the past two weeks. This will unfortunately be the result if the Commission does not extend the scheduled February 18 date for the LMDS auction by at least 60-90 days.

Respectfully submitted,

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Dated: February 12, 1998.

Attachment 1

Expert Analysis of
Ronald M. Harstad, Ph.D
February 11, 1998

Competition in the LMDS Auction

Most economists viewed the WCS auctions as a clear failure. A second failure to generate decent revenue, shortly afterwards, could have far-reaching implications for future auctions.

Commission expectations of as much as \$4.1 billion (reported in Telecommunications Reports, Feb. 9, 1998) need to be re-evaluated in view of bidders' deposits. Upfront payments for the LMDS auction total about \$358 million, so that the auction will begin with an eligibility ratio of only 1.74. Moreover, few bidders put up enough money to give them flexibility to bid for the more populated BTAs: only two bidders can compete simultaneously in the four largest markets, and less than a dozen can bid for any one of these four A block licenses.

Revenue will not come close to the \$4.1 billion expectation. Two scenarios arise, depending upon the FCC's reaction to licenses that do not obtain any bids in the first several rounds.

First, they can reduce minimum opening bids early and often. This will result in selling most licenses, perhaps 80%. Pessimistic estimates of the revenue that would be obtained would be \$100-\$300 million. Optimism might afford estimates in the \$300-\$500 million range; even this upper end may move too far from realism.

Second, the FCC can leave minimum opening bids at the levels set for round 1, even on licenses that continue to draw no bids. An appropriate assessment of this policy choice must consider both revenue now and anticipated revenue from reselling unsold licenses after the market has settled down. My estimate from this scenario is that from 60% to as high as 90% of the licenses could go unsold. Revenue on the minority of licenses that draw bids could range from \$50 million to, optimistically, \$250 million.

To complete the picture: if the majority of LMDS licenses that went unsold at the pre-set minimum opening bids and were auctioned off later (with rules and procedures unchanged for five or six months, rather than in continual flux) revenue in this later sale might reasonably be in the \$600 million - \$1.2 billion range. Even higher levels are not impossible, but it would require attracting major telecom players who I believe are now sitting on the sidelines, waiting for the picture to clarify.

Attachment 2

Curriculum Vitae of Dr. Ronald M. Harstad

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Ronald M. Harstad is a professor at the Rutgers University Faculty of Management, Department of Finance and Economics, and a member of RUTCOR (Rutgers Center for Operations Research). He is also Area Editor for Games and Experiments at the International Journal of Game Theory.

His research interests include auction theory and bidding theory, laboratory experiments in economics and games, game theory, and quantitative economics. He has authored or co-authored over two dozen refereed publications.

Harstad received a Ph.D in Economics from the University of Pennsylvania in 1977, and a B.Sc. in Economics and the Honors College from Michigan State University in 1973.

He joined RUTCOR in 1991, and Rutgers University in 1993. His previous tenured or tenure-track appointments included the Universities of Houston and of Illinois at Urbana-Champaign, and Texas A&M University, and he has been a visiting professor at the University of British Columbia. Temporary research professorships have included the Universities of Bonn and of Virginia, and the Center for Interdisciplinary Research in Bielefeld, Germany.

Technical Expertise and Skills

- Designing auctions, and bidding effectively
- Behavior-based assessment of environmental damage
- Behavior-based assessment of new product demand, especially telecommunications services
- Competitive planning of rival behavior in concentrated industries

Selected Publications

"Withdrawable Bids as Winner's Curse Insurance" (with M. H. Rothkopf), *Operations Research*, 43 (1995), 983-94.

"Comparative Static Effects of Number of Bidders and Public Information on Behavior in Second-Price Common-Value Auctions" (with J. H. Kagel and D. Levin), *International Journal of Game Theory*, 24 (1995), 297-319.

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